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Audit's

MARKET ANALYSIS OF SECURITIES OF REITS AND REAL ESTATE COMPANIES

Realty Stock Review

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MARKET STRATEGY: LIQUIDITY PRESSURES POINT TO CONTINUED QUALITY FOCUS

Expect the unexpected. The market for realty stocks right now looks much like a road thru a valley -- with plenty of bomb craters around before the steeper recovery climb begins.

We think your holdings should have a stodgy look right now -- because halitosis is better than no breath at all. In that vein we are removing several stocks from our Portfolio Selector that appear hardest hit by the double whammy of the October market crash and weakness in many property markets. Institutional illiquidity in many banks and S&Ls, especially in the Southwest, is exacerbating this situation.

The clearest evidence of this bite came when **Southmark Corp.** (\$3.63--NYSE) announced it had agreed to buy control of **Johnstown American Cos.** (\$1.25--ASE) for \$7 mil. and lend, thru its S&L subsidiary, \$25 mil. to JAC. Four business days later SM omitted its quarterly dividend to "preserve capital." SM said it would save \$2.75 mil. per quarter by not paying a 6¢ quarterly dividend.

We are removing both Southmark and Johnstown American from Portfolio Selector till the situation clarifies, even tho it means a loss for investors who

bought previously and even tho we may be selling at the bottom and missing some recovery in these two depressed stocks.

SM cited weakness in property markets, which may slow it in its goal of selling \$500 mil. of assets this year to repay some of its \$2.4 bil. debt. SM has a \$125 mil. principal payment due Nov. 1989. SM's Dec. qtr. earnings fell 71% to 2¢ after preferred dividends. Property sales must pick up strongly to give SM an uptick in its June fiscal year EPS.

Debt maturities without liquidity were what forced JAC and its energetic chairman, John Lie-Nielsen, into the arms of Southmark. As noted in our review of Dec. 24, 1987, JAC had been struggling under a mountain of debt since it borrowed heavily in July 1985 to pay \$150 mil. for Emeryville, Cal. syndicator Consolidated Capital, manager of five publicly traded REITs plus numerous public partnerships.

It negotiated that price downward to \$90 mil. last fall but by that time bank debt was starting to come due. In Jan. JAC said it was going thru the annual renewal of its bank credit lines but apparently the need for cash became so pressing that Nielsen was forced into selling all his Class B shares, which received 10 votes per share but a lower

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dividend, and most Class A shares at \$1.375 per share (or about \$7 mil.). SM thus gets 70% voting control of JAC.

Southmark's San Jacinto S&L will lend \$25 mil. to JAC, with \$5 mil. of these loans convertible into JAC common at \$1.375, subject to JAC shareholder approval. Also SM will receive five-year warrants to buy 6.0 mil. JAC shares at \$1.65 per share.

The deal is billed as the marriage of two leading property trading and management companies with much potential synergism. This is the only aspect of the deal that attracts us. As outlined in Dec., JAC thought it was buying a major league syndicator in ConCap, when in reality troubles in its property portfolios, highly publicized for **ConCap Income** and **ConCap Special Trusts**, turned many selling broker-dealers wary of new product. JAC thought it had licked the problems but there wasn't enough time to keep the banks happy.

While the sun set on ConCap, Southmark was moving to the fore as a major national syndicator. It now is one of the nation's largest and should be able to breath new life into ConCap. Also, SM manages 322 apartment complexes with 100,000 units and addition of JAC's property management skills should boost this element of SM's operations.

While the market focused on this negative news, big buyers continued to chase realty stocks they consider depressed. Items:

--**Countrywide Credit Industries Inc.** (\$9-1/4--NYSE), Pasadena, Cal. based mortgage banker now servicing about \$7.6 bil. mortgages, attracted buying interest from the Belzberg family, whose multiple entities said they bought a 6.6% stake. CCR shares rose about 50% on the news and we would not be averse to taking some profit, although we retain the stock in Portfolio Selector.

The Belzbergs, thru American Capital Fidelity Corp., Far West Financial Corp. and Far West S&L, all based in Newport Beach, Cal., said they will

contact CCR management to discuss working with them, and may seek to acquire a controlling position, effect a business transaction, or seek board representation. They paid from \$5 to \$6.50 for their 1,003,900 shs.

The Belzbergs base in Vancouver, B.C. and entered U.S. securities markets after building a major Canadian realty empire. In the early 1980s they took over and liquidated the former Denver REIT and the former State Mutual Investors REIT.

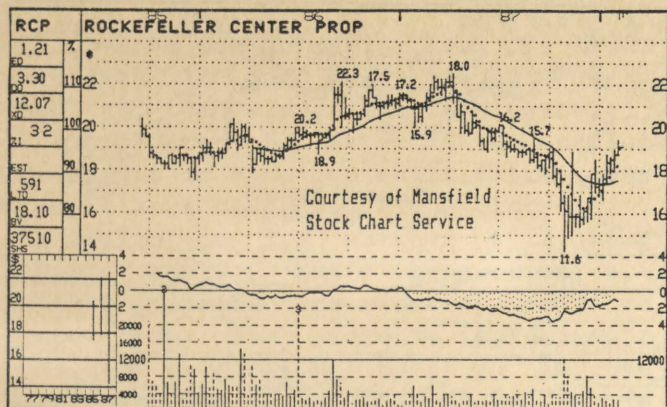
Consolidated Capital Income Trust (\$7-1/4--OTC) and **Consolidated Capital Special Trust**, (\$5-3/4--OTC) both managed by the ConCap arm of Johnstown American (see above) received an unsolicited proposal from Balcors Co., the syndication arm of Shearson Lehman Bros., to acquire the trusts for \$8.50 and \$6.50 per share respectively. Trustees of the two trusts rejected the offer, which was at 59% and 55% of book values respectively. Balcors said it is considering its options. ConCap Income shareholders rejected last spring a takeover attempt by Australian investors led by Industrial Equity (Pacific) Ltd., managed by Investor Ron Brierley.

We include this issue reviews of three diversified REITs which look to us to have small downside risk, and a health care REIT with high yield and excellent potential.

RANKING REVIEWS: THREE REITS WITH SOUND PROSPECTS AMID SOGGY PROPERTY MARKETS

As we said on page 1, stodgy is the investment theme for 1988. And our choice for a core holding is **Rockefeller Center Properties, Inc.** (\$19.25--NYSE) for its interest in a world class urban center in Manhattan. Sure, we know RCP was sold to the public in Sept. 1985 in a deal in which public investors paid a very fancy price to ride with the Rockefellers.

But stodgy RCP is doing some very unstodgy things that should provide very significant long-term values for shareholders. The two big items:



--In Dec. they cut a deal with NBC that leaves this major tenant occupying about 19.4% of Rockefeller Center's 6.2 mil. sq. ft. into the middle of the next century; and

--They began buying current coupon and zero coupon debt issues to limit the massive dilution overhanging RCP common.

EPS/Dividends - B (Dec. years:)

	1986A	1987A	1988E	% Chng.
EPS.....	\$1.26	\$1.33a	\$1.38	5.9%
Cash flow..	\$1.73	\$1.80	\$1.84	3.1%
Dividend..	\$1.76	\$1.80	\$1.82	1.7%

a-Includes 11¢ from debt repurchase.

Net cash flow exceeded earnings under general accounting principles by about 57¢ sh. in 1987, attributed to amortization of discount upon zero coupon convertibles. RCP paid a \$1.80/sh. dividend, of which 25.8% (46.4¢) was taxfree capital return because of the zero coupon amortization. This tax-free portion boosts the 9.3% current yield to a 10% effective yield.

Assets and Operations: RCP owns a \$1.3 bil. loan due 2007 convertible on Dec. 31, 2000 into 71.5% general partnership interest in Rockefeller Center in Manhattan. The 6.2 mil.-SF office and retail space in the Center has 1.7% vacancy (vs. about 9.1% vacancy for midtown Manhattan). New and renewal leases averaged \$41.30/SF in the Sept. qtr., up about 2% in the last year. One continuing play in RCP is its potential to close the 30% gap between old leases yielding average effective \$29/SF rents and market rent.

The Dec. deal with NBC ended the major unknown for RCP in space leasing. NBC had rented about 19% of space at

\$17.30/SF thru 1994. NBC and RCP's borrower, Rockefeller Center Inc., agreed on a complex plan which lets NBC receive city subsidies to modernize much of its space and pay net rent (i.e., NBC will pay its own expenses including taxes) based on the type of space.

Most office space will net lease at \$32 per SF, which RCP calculates is equivalent to \$63 per SF gross rent. This is about 91% of gross rent projected by RCP in its initial offering. Better, the lease removes threat that large amounts of NBC space might become vacant and require renovation to become leasable. The NBC lease runs to 2022 with renewal options running to 2052.

Meantime RCP continues modernizing lobbies and halls on multi-tenant floors under a \$200 mil. 14-yr. modernization.

Financial Measures - C: The second big play in RCP is its move to limit dilution. RCP is financed with \$335 mil. current coupon debentures (8% thru 1994, 13% thereafter till 12/31/2000); and \$952.25 mil. zero coupon debentures due 2000 (sold at 22.58% of par to yield 10.23% to maturity). The debentures are convertible into 28.34 mil. and 43.86 mil. shs. respectively on Dec. 31, 2000, or 25.8% and 40.0% of equity then.

If all converted, common holders would own only 34.2% of the Center. The sweetener to common holders is that amortization of the zeros is a non-cash charge that makes between 27% and 52% of dividends a non-taxable return of capital over the years. Moreover payout is being subsidized by a \$350 mil. letter of credit since the Center still does not generate enough cash flow to service the \$1.3 bil. loan.

In December RCP began buying these convertibles in overseas markets and reported a \$4.3 mil. gain by year-end. It's impossible to predict how many convertibles might be purchased ultimately, but RCP is doing this with fixed rate debt at about the same interest cost. The net effect would be to replace convertible debt with fixed rate debt, which can only increase longer-term value of the underlying common.

Exposure - B: We are maintaining our B Ranking. RCP holders get a tax-advantaged ride on value gains by this premier Manhattan property. So far the

property has performed about on schedule and the NBC deal effectively removes leasing risk. Management's move to limit dilution should have very positive longer-term value implications. We restate our earlier buy advice.

HRE Properties (\$23.50--NYSE), holds A Rank. HRE should show steady, albeit uninspiring results in 1988 after a disappointing year in 1987. HRE's focus on quality properties, proactive improvements and strong financial footing provide a buffer against, and should stem any further declines in occupancy and earnings.

EPS/Dividends - A (Oct. years):

	1986A	1987A	1988E	3 Yr.%
EPS.....	\$1.79a	\$1.35	\$1.35	-13%
CFS.....	\$2.34a	1.85a	1.85	-11%
Dividend.\$	2.28	1.92	1.80	-11%

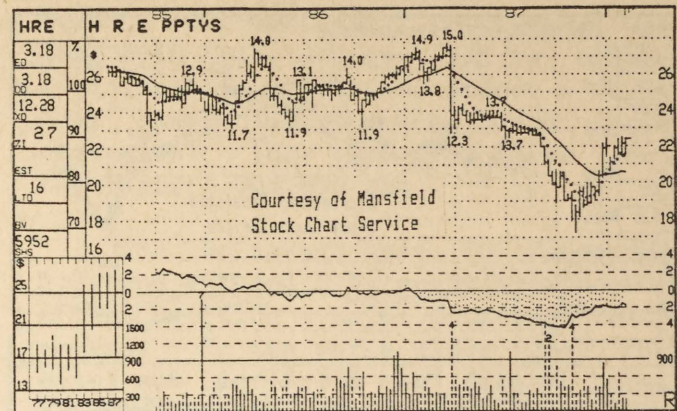
a-Before property sale gains of \$0.15/sh. in 1986 and \$0.17/sh. in 1987.

HRE sold a Sterling Heights, Mich. store and land in 1986 for \$4.2 mil. gain to be reported over 10 years (about 7¢/sh. per year). With the repayment of a \$13.4 mil. 13-1/4% mortgage, HRE's interest income has decreased as similar investments are not available today. Dividends dropped 21% in early 1987 from \$0.56 (\$2.24 annualized) to \$0.45 (\$1.80 annualized) after five years of steady growth.

Assets: Today 86% of assets are in properties owned or held in joint ventures. Another 5% are mortgages with equity participations and 9% are long-term fixed rate mortgages. Assets are now 44% offices (ownership interests in six offices with 634,050 sq. ft. plus participating mortgage on a seventh); 41% retail (interests in three shopping centers and six department stores with 1.15 mil. SF, 97% leased); and 15% service and distribution facilities with 1.56 mil. SF.

Operations: Office properties were a disappointment in 1987 with overall occupancy dropping to 88% from 94% in 1986 increasing the downward pressure on rents. Operating lease income declined by 6.2% due primarily to the absence of \$400,000 in rents from the Sterling Heights retail property sold in 1986.

In 1987 three of HRE's office properties declined in occupancy; two of



them primarily due to soft southwest office markets. Trammell Crow Co. was engaged to manage HRE's Houston property which has declined to 70% occupancy. Occupancy has also declined at HRE's Portland property to 77% (from 92% at the beginning of 1987) and at its Denver property to 84% due to a bankruptcy and the loss of two tenants that moved out of state. HRE forecasts that by its July quarter occupancies will be at 92% and 90%, respectively. The remaining office properties are near full occupancy with the exception of Charlotte which is approaching 80%.

Retail properties have been steady performers. The six department stores and three shopping centers continue to be 97% leased. Every center with percentage rent leases is now in overages. The Springfield, Mass. mall has been expanded to 277,000 SF with the completion of 40,000 SF in 1987 and 70,000 SF in 1986; 90% of the new space is leased. The major expansion at the Manassas, Vir. mall, started by HRE and its partners in 1986 is nearing completion.

Leases on HRE's distribution and service properties mostly run until the mid-90's. HRE is currently dependent on three large tenants but has the option to develop these properties for multi-tenant use as local demographics change. HRE is converting its Newington, NH property to office and retail use and may realize significant rent increases.

Financial Measures - A: HRE's debt of \$14 mil. is a low 0.1 times \$137.0 mil. equity, or \$22.99/sh. Only one of HRE's 25 properties is mortgaged, a 50% interest in a 211,000 SF Portland, Ore. office. Early in 1987 HRE repaid a \$2

mil. 8-1/4% participating loan due 1988. Liquidity is good (HRE has \$2.76/sh. cash) and the balance sheet is strong.

Exposure - B: Exposure to office conditions in some overbuilt cities, has brought some headaches altho increasing absorption in its markets will help support rents. HRE's properties are generally prime and stand up well to competition. With property improvements and cost controls HRE hopes to improve margins. 1987 dividend of \$1.92 is about 97% of 1987 operating cash flow. The current \$1.80 dividend yields 7.7%. Low leverage limits downside risk.

Property Trust of America (\$9.63--OTC), holds A Rank as 1987 was a modest recovery year, following a 33% dividend cut a year ago. But the stock is just about where it was a year ago after the cut, meaning investors are hanging in for a turnaround. Based in El Paso, Tex. PTRAS, a small but growing REIT, owns a diversified portfolio of South-west and Mountain income properties.

EPS/Dividends - B (Dec. years):

	1986A	1987E	1988E	% Chng.
EPS.....	\$0.63	\$0.60	\$0.63	NM%
Net CFS...	\$0.93	\$0.88	\$0.93	0.0%
Dividend..	\$1.20	\$0.80	\$0.80	NM%

EPS under GAP accounting will be down in 1987. Operating net cash flow of about 87-88¢ will be down 5%. We expect some modest gains in 1988 to about 92-95¢ per share, with about 4% variance possible. PTRAS didn't sell any properties in 1987, foregoing a fund source that had shored up the dividend. Some sale gains may be recorded in 1988 as an El Paso apartment is on the market. PTRAS cut payout for 1987 to 80¢ sh. and this was well covered from operating cash flow in 1987. No dividend increase is expected until cash flow reaches mid-90¢ range. At current prices the shares yield about 8.4%. About 20% of 1987 payout was taxfree return of capital.

Properties: About 33% of PTRAS's estimated 88¢ per share net operating cash flow in 1987 came from retailing. Major retail properties include 10 shopping centers with 685,000 SF of retail space, with 69% in Denver or Colorado Springs and the remainder in El Paso. PTRAS is renovating and expanding one

Denver center; occupancy overall is 92%

Hotel and office holdings each generate about 13% of cash flow. One of PTRAS' most successful investments is its 50% partnership interest in the 338-room Holiday Inn on Fisherman's Wharf, San Francisco, giving PTRAS significant entree to this major tourist market. The hotel's cash flow fell in 1986 when guarantees expired but has recovered strongly, helped by Japanese tourism. Apartments are expected to improve in 1988 over the year-end 90% occupancy, although markets are competitive.

PTRAS owns only one 67,500 sq. ft. office building, Crown Tower in San Antonio, and although exposure was small, a large tenant left and occupancy (now 73%) is recovering slowly. A 40% interest in a second Fort Worth office building is better at 80% occupied.

Financial Measures - A: PTRAS has excellent liquidity and low leverage. Leverage is low with about \$14 mil. of debt being only 0.32 times \$44 mil. shareholders' equity.

Current Value: Management puts value at about \$12 per share, altho this isn't validated by appraisals.

Exposure - A: PTRAS' liquidity and conservative financing position it ideally for an eventual Southwestern real estate turnaround.

**RANKING REVIEW: HEALTH CARE REITS
CONTINUE WITH STRONG MARKET SHOWINGS**

One of the strongest groups following the October market crash was the medically oriented REITs. These REITs net lease medical properties from health care operators, both their sponsors and third-party operators, giving them a higher and potentially growing income stream. Investors seem to be making a yield and credit judgment on the stocks.

They remind us of some 1970 vintage REITs with their delicate interplay between borrowing costs and lease income from their completed property holdings. They balance leverage and spread on borrowings, often borrowing short to buy properties and then funding purchases with longer-term fixed-rate debt. But, high levels of short-term debt can cause potential mischief if debt can not be

funded long-term.

With medical services becoming increasingly competitive and pressured by cost-conscious government regulators, these REITs are not without risk. The sponsor of one of the largest, nursing home operator Beverly Enterprises Inc., reported major losses in its Dec. quarter and other smaller operators have been under pressure. We review here one which has compiled good records to date.

Health Care Property Investors Inc. (27.38--NYSE), the first of this generation of health care REITs, has led the way for others with these firsts:

--First health care REIT to buy properties leased to third-party operators, ending any fear it would be a passive off-balance sheet financing tool for its sponsor.

--First health care REIT to move toward a portfolio diversified by property types.

--And (a hunch), may be the first to become internally administered and end all official ties to its sponsor.

EPS/Dividends - B (Dec. years):

	1986A	1987A	1988E	% Chng.
EPS.....	\$1.79	\$1.74	\$1.70	-2.5%
Net CFS...	\$2.61	\$2.82	\$2.90	+5.4%
Dividend...	\$2.30	\$2.46	\$2.62	+6.7

EPS under general accounting are declining because of higher depreciation charges. Net operating cash flow is the number to watch. We are projecting a slower cash flow growth in 1988 because of uncertainties about interest rates. Any sudden rise in rates would put HCP under modest pressure. HCP raised its dividend to 64¢ quarterly for the Feb.

19 payout, ninth consecutive quarterly rise of 1¢ each. While we admire this record, we worry about what happens when the string is broken.

Assets and Operations: HCP is sponsored by National Medical Enterprises, a major investor owned health care company which owns 6.0% of shares. At its May 1985 initial offering, HCP bought and leased back interests in 25 health facilities from its sponsor. Since then HCP has expanded substantially and ended 1987 with 12,300 beds in 99 facilities in 27 states.

Facilities consist of 90 long-term nursing home facilities, four congregate care facilities, one psychiatric center, two acute care hospitals, and two rehabilitation hospitals. Operators include Columbia Corp. and Arbor Health Care Co. in addition to Hillhaven Corp., an NME subsidiary.

Most HCP leases are structured to provide base rents as if the properties were 100% occupied, and may earn additional rents if patient receipts exceed base levels. Units remain about 90% occupied and 37% are private paying.

Financial Measures - B: Debt of \$138.6 mil. at Sept. 1987 was 0.85 times equity of \$162.8 mil. or \$19.96/sh. We treat HCP as a cash flow REIT and add back \$1.73/sh. accumulated depreciation. HCP has issued \$75 mil. in 9-7/8% senior notes to repay \$58.1 mil. short-term debt (42% total debt).

Exposure: While there's modest interest rate and spread risk, HCP has moved aggressively to establish an independent operating stance and track record. We assign an initial B rank and continue shares in Portfolio Selector.

COMPARATIVE REALTY STOCK GROUP AVERAGE 02/10/88

GROUP NUMBER & NAME	DIV	NON-DIV	TOTAL	SHARE (000)	BOOK VALUE	ANNUAL DIV	EARN ANN	LAST PRICE	-% CHANGE FROM JAN 27	JAN 1	P/E RATIO	ANNUAL YIELD	% PR TO BK	RETURN ON BK	MARKET VAL (000)
1 PROPERTY REITS	43	4	47	7166	10.03	0.97	0.83	13.16	2.9	8.4	15.8	7.4	31.2	8.3	4819.1
2 LEASEBACK REITS	13	0	13	6230	14.17	1.59	1.59	14.04	1.7	8.0	8.8	11.3	-0.9	11.2	1348.2
3 PROP & MTG COMB REITS	19	2	21	5775	13.01	1.32	1.28	13.20	4.3	10.3	10.3	10.0	1.5	9.8	1677.5
4 MORTGAGE REITS	17	1	18	6834	13.84	1.47	1.75	12.22	1.7	9.5	7.0	12.1	-11.7	12.6	1524.6
5 PARTICIPATING MTG REITS	12	0	12	8559	11.54	1.08	1.04	10.09	-0.6	8.3	9.7	10.7	-12.5	9.0	1264.2
6 MAJOR HOMEBUILDERS	8	4	12	20778	9.88	0.29	1.19	10.18	12.1	18.1	8.6	2.9	3.1	12.0	2137.5
7 OTHER BLDRS/DEVELOPERS	7	25	32	7058	5.36	0.14	0.31	6.08	3.7	12.5	19.7	2.3	13.4	5.8	1392.3
8 INCOME PROP BLDR/OWNER	23	10	33	8925	11.60	0.85	0.70	14.11	4.0	9.6	20.2	6.0	21.6	6.0	3721.8
9 MORTGAGE BANKER/FINANCE	12	5	17	13899	10.48	0.84	0.66	11.25	4.4	12.7	17.0	7.5	7.4	6.3	4566.4
10 DIVERSIFIED RLTY&HOLDING	11	7	18	20467	13.68	0.30	0.25	13.77	1.0	4.3	54.7	2.2	0.7	1.8	9732.9
11 RLTY SVCS/SYNDICATORS	2	6	8	8283	5.70	0.30	0.56	6.89	3.8	8.4	12.3	4.4	20.9	9.8	417.7
12 MANUFACTURED HOUSING	4	6	10	8873	6.91	0.15	0.11	6.66	2.3	7.7	59.5	2.3	-3.5	1.6	874.3
13 ASBESTOS ABATEMENT CO	0	5	5	20772	2.84	0.00	0.02	3.43	14.2	-7.1	171.3	0.0	20.5	0.7	291.0
L LIQUIDATING COMPANIES	2	4	6	6827	7.92	0.21	0.38	4.81	5.2	13.8	NC	NC	-39.3	NC	205.8
P PREFERRED STOCKS	1	0	1	1650	10.00	1.10	0.00	11.50	4.5	8.2	NC	NC	15.0	NC	19.0
OVERALL AVERAGE			253	9748	10.34	0.79	0.81	11.30	3.3	9.6	14.0	6.9	9.3	7.6	33992.2
DOW JONES INDUSTRIALS							137.99	1962.04	2.7	1.2	14.2	3.5			
STANDARD & POOR'S 500							15.86	256.66	2.9	3.9	16.2	3.4			
DOW JONES UTILITIES							18.12	186.11	1.2	6.3	10.3	8.6			